

The Market newsletter addresses topical matters concerning interpretations, regulation, as well as supervisory findings relating to listed companies' disclosure obligation, financial reporting enforcement, securities trading and insider issues. Articles other than those pertaining to IFRS enforcement will appear mainly in English. The newsletter is published by FIN-FSA's Supervision of Markets and Conduct of Business Department.

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Topical matters at ESMA

ESMA invites comments on level 2 and 3 regulation related to money market funds. Comments are requested by 7 August 2017.

ESMA has issued a new Guideline under the reformed Markets in Financial Instruments Directive (MiFID II) regarding investment firms' product governance processes. The Guideline will enter into force on 3 January 2018.

ESMA is currently preparing advice to the Commission on level 2 regulation related to the new EU Prospectus Regulation. The request for consultation will likely be published in summer 2017.

ESMA is preparing an update to a guideline issued in 2012 on suitability assessments under MiFID. The Guideline is intended to be updated in line with the reformed Directive (MiFID II). The request for consultation will likely be published in summer 2017.

Models for notifying managers' transactions

In order to facilitate and harmonise reporting, FIN-FSA has prepared models for the notification of transactions by persons discharging managerial responsibilities. In addition to the most common notification types, examples have also been prepared for the notification of option rights and share-based remuneration as well as transactions based on incentive and share-saving schemes. In addition, there are models for the notification of board of directors' remuneration and subscription rights.

The models do not cover every circumstance of reporting managers' transactions, but further examples can be added where necessary. The examples (available in Finnish) are found on the MAR pages of the FIN-FSA website [Johtohenkilöiden liiketoimet ja suljettu ikkuna](#) (managers' transactions and the closed period).

Further information on the notification models

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On the emergence of inside information and establishment of insider lists

In the course of conducting its supervision, FIN-FSA has observed that, after the entry into force of the Market Abuse Regulation (MAR), the timing of the establishment of insider lists has been postponed in some cases. For example, in protracted processes, an insider list may have been established only when the issuer has had full certainty of the execution of the project. As a rule, FIN-FSA considers this too late, since the criterion of precise information is already fulfilled when there is a real possibility of the occurrence of a circumstance or event. This is also stated in the explanatory text of Nasdaq Helsinki Ltd's Guidelines for Insiders: *"However, the arrangement should be considered a project at least once the listed company has been informed of its inclusion in the second/actual bid round. The need to establish a project also depends on the number of other potential buyers and the strategic intent of the bidder with respect to closing the final acquisition."*¹

The definition of inside information in MAR corresponds in key respects to the previously applied definition contained in chapter 12, section 2 of the Securities Markets Act. The entry into force of MAR has not introduced any changes in the assessment of materiality and precision, that is, when information is sufficiently material and precise to qualify as inside information. After the entry into force of MAR, disclosure obligation is directly linked to the definition of inside information and issuer will have to assess the existence of the criteria for the delay of the public disclosure of inside information. The fact that an issuer will have to take the decision on whether to delay the public disclosure of inside information does not affect the assessment of the materiality and precision of inside information.

FIN-FSA emphasises that the materiality and precision of inside information must continue to be assessed by the same standards that applied under previous regulation.

The emergence of inside information and related obligations

In accordance with Article 7 of MAR, inside information comprises information of a precise nature, which has not been made public, relating to an issuer or financial instru-

ment, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

The emergence of inside information is contingent on the materiality and precision of the information. Significant effect on the prices of financial instruments (materiality of information) means information that a reasonable investor would be likely to use as part of the basis of his or her investment decisions.

At the same time, the precision of information indicates a set of circumstances which exists or which may reasonably be expected to come into existence, or an event which has occurred or which may reasonably be expected to occur. However, the precision of information does not require a set of circumstances or an event which can be assumed to likely occur or come into existence; it is enough that there is a realistic prospect that they will come into existence or occur.

Information is deemed precise enough when it enables a conclusion to be drawn as to its possible effect on the price of the company's financial instrument. It does not matter whether the direction of the potential price impact of the information can be determined in advance.

As regards information related to the time of emergence of inside information, assessment of the precision of the information is key. Where the issuer has determined that the preconditions for delaying the disclosure of inside information are in place, it marks the beginning of the issuer's obligation to prepare an insider list. Inclusion in an insider list also triggers a ban on disclosure, advice and trading on those included on the list.

Establishment and reliable maintenance of an insider list

The drawing up and updating of insider lists are prescribed in Article 18 of MAR and the Commission Implementing Regulation (EU) 2016/347 issued under it. Issuers or any person acting on their behalf or on their account, shall draw up an insider list indicating all persons who have access

¹ Nasdaq Helsinki Oy Guidelines for Insiders of Listed companies 3 July 2016 paragraph 1.3.3.1.



to inside information and who are working for them under a contract of employment, or otherwise performing tasks through which they have access to inside information, such as advisers, accountants or credit rating agencies.

FIN-FSA emphasises that the establishment of an insider list is a matter of insider management by the issuer. Insider lists are also a key tool in FIN-FSA's supervision of misconduct.

An insider list must be drawn up in an electronic format and updated without delay whenever:

- there is a change in the reason for including a person who is already on the insider list
- a new person has access to inside information and therefore needs to be added to the insider list or
- a person ceases to have access to inside information.

In connection with making an update, mention should be made of the date and time when the change leading to the need to make the update occurred and when the update was made.

In accordance with Article 2.4 of the Commission Implementing Regulation, electronic insider list maintenance shall ensure:

- the confidentiality of the information included by ensuring that access to the insider list is restricted to clearly identified persons from within the issuer, or any person acting on their behalf or on their account that need that access due to the nature of their function or position
- the accuracy of information contained in the insider list
- access to and the retrieval of previous versions of the insider list.

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Regulation on revenue recognition of listed companies will change in 2018 – investors expect information on the changes

As of the beginning of next year, listed companies will apply the new standard IFRS 15 *Revenue from Contracts with Customers*, which regulates the reporting of revenue recognition in financial statements. Since the standard may have a significant impact on listed companies' revenue recognition principles and therefore on their key figures, the Financial Supervisory Authority (the FIN-FSA) reviewed the information disclosed by 70 listed companies in their financial statements for 2016 on the estimated impacts of the implementation of the new standard. The FIN-FSA mainly looked into how the companies had applied the good practices for disclosures included in a statement issued by the European Securities and Markets Authority (ESMA)¹. The ESMA Public Statement highlights the need for consistent and high-quality implementation of the new standard, and the need for transparent reporting to investors. Revenue is such a key performance indicator in financial statements that users of financial statements must be able to evaluate the impacts of the implementation of the standard before it becomes effective.

Almost all listed companies had considerably increased the information disclosed on the implementation of the standard in their financial statements 2016, compared to the financial statements 2015. Many companies provided a more extensive depiction of their revenue streams, and most of the descriptions were also company-specific. The companies, therefore, made less use of standard phrases that merely repeated the wording of the standard (boilerplate). Only a few companies presented quantitative information on the impacts. Less than 10% of the companies estimated that the implementation of the standard will have a significant financial impact. There may, however, be a significant impact on, for example, a company's accounting practices, processes or systems, even if the quantitative impact on its revenue and/or profit or loss proves to be minor.

The FIN-FSA considers the implementation of the new standard to be one of the main changes affecting IFRS reporting, for which careful preparation must be made. For this reason, in 2016 the FIN-FSA reviewed preparations

¹ https://www.esma.europa.eu/sites/default/files/library/2016-1148_public_statement_ifrs_15.pdf.



by companies for the implementation of the new standard by means of a questionnaire directed to boards of directors / audit committees. The FIN-FSA concluded that many companies were running late in their preparations.² The FIN-FSA, however, believes that companies have begun preparations for the implementation of the standard no later than early 2017. The FIN-FSA draws the attention of companies to the fact that thorough analysis and the documentation thereof are needed in the context of a major change in applicable standards. This need is further emphasized by the increasing degree of management judgment required by the implementation of the standard. Even where the standard has no significant quantitative impact, companies must prepare sufficiently detailed analyses to support this conclusion.

Under ESMA's leadership, European IFRS enforcers are reviewing the information provided on the implementation of the standard in financial statements for 2016 and half-yearly reports for 2017.

The ESMA Public Statement and impact of the standard's five-step model for companies' different revenue streams

According to the ESMA Public Statement, companies would be well advised to present a detailed description and explanation of how the standard will be applied to different revenue streams. The description should cover, for example, the identification of performance obligations, the determination and allocation of the transaction price, and

how performance obligations are satisfied and revenue is recognised. All of the above are parts of the standard's new five-step model. The simplified example in Chart 1 illustrates this model.

The companies made a relatively extensive disclosure of the impacts of the standard in their financial statements 2016. 30% of the companies presented information on the application of the five-step model to the extent proposed by ESMA in its examples of good practices for disclosures. Companies that expected the implementation of the standard to have a significant impact generally disclosed extensive information.

Information disclosed by companies on step 1: Identify the contract with a customer

In the implementation of the standard, all of the company's different contracts with customers must first be identified. Even if the company uses common contract templates, they may have been adapted to the needs of different customer groups. The large variety of contracts with customers has taken many companies by surprise. Successful review of contracts requires close cooperation between the finance and sales departments, since often only the sales organisation has information on the actual content of the contracts. Review of contracts may therefore have taken more time than planned.

Below are examples of disclosures made by companies in their financial statements 2016 on the content of contracts with customers or a review thereof:

"The delivered goods have been identified in the contracts the company has made with the customer (for example the quality and measurements of the product have been defined). The contracts often define the target for quantities to be delivered, but the customer is not committed to the quantities. The supplied quantities are based on the customer's purchase orders and each supplied quantity is invoiced separately."

"For all revenue streams the results of the initial scan of revenue recognition policies have been validated by a contract review of the key revenue contracts. As regards X, the main finding is the need to identify additional performance obligations in cases of providing gifts as premiums to new customers. As regards Y,

Chart 1: An example of the five-step model of IFRS 15

Step 1: Identify the contract with a customer	Step 2: Identify the performance obligations	Step 3 ja 4: Determine the transaction price and allocate it to the performance obligations	Step 5: Recognise revenue as the performance obligations are satisfied
Contract with a customer	Piece of equipment	€	When delivered
	Training service	€	When performed
	Maintenance service	€	When performed
	Warranty	€	Over the period

² http://www.finanssivalvonta.fi/fi/Listayhtiolle/IFRS/Julkaisut/Esitykset/Documents/Fivan_listayhtiotalaisuus_2016.pdf, see page 23 (In Finnish).

in some cases multiple performance obligations need to be acknowledged, which need to be recognized at different moments (over time or at a point in time), depending on the characteristics of the performance obligations.”

Information disclosed by companies on step 2: Identify the performance obligations

The second step consists of the identification of the different promises included in the contracts, that is, the performance obligations. This step involves more guidance than at present³, and it has therefore been one of the steps that has stimulated most deliberation and changes. Management judgment is required, for example, in determining when performance obligations belong together and when they should be separated.

Also at this step, close cooperation between the company's different functions is required to ensure that all promises included in the contract are identified. The company's customary business practice may involve, for example, giving the customer a product or service not indicated in the contract in connection with its performance. Such a business practice could potentially give rise to a separate performance obligation that must be identified from the perspective of revenue recognition, even if deemed to be gratuitous. This matter is addressed more specifically in step 4 (allocate the transaction price to the performance obligations).

Almost half of the companies reviewed by the FIN-FSA disclosed something about their performance obligations, for example as follows:

“Revenue recognition may deviate from current practice with respect to the following items:

- The number of performance obligations taken into account in revenue recognition might grow in situations where a contract also covers services other than X (e.g. Y or Z).*
- Changes and additional work are handled as separate performance obligations, when this involves a new obligation not included in the original contract.”*

“Sales contracts could give customers the option to purchase additional goods, which may be priced at a discount. These kind of options are considered to be separate performance obligations, and the revenue can

be recognized if it provides a material right to the customers. The right is material if it results in a discount that the customer would not receive without entering into the contract. If the discounted price in the option reflects the stand alone selling price, it is deemed to be more a marketing offer than a material right. According to the analyses there may be these kinds of options in a few contracts and thus will have some effect on the timing of the revenue recognition. Current practise is to recognise the revenue when the customer is utilizing the option.”

“With regards to services and bundles of services transferred to customers, the Group takes into account that based on the preliminary analysis, some of the performance obligations currently considered distinct may be recognized together with another as one performance obligation.”

Information disclosed by companies on step 3 and 4: Determine the transaction price and allocate it to the performance obligations

The third step involves the determination of the transaction price, which cannot be automatically assumed to always equal the price indicated in the sales contract. The company must determine the amount of consideration it expects to be entitled to. It may include fixed or variable considerations, or both. Since current regulation does not recognise the principles of the determination of consideration, companies must analyse the impacts of these principles on their current practices.

In the fourth step, the transaction price is allocated to the performance obligations based on relative stand-alone sales prices. Due to the allocation requirement, the company must determine a stand-alone selling price for each performance obligation, also including any “gratuitous” performance obligations referred to above in step two (identify performance obligations). The standard includes different methods for the assessment of the stand-alone selling price. The allocation requirement is new regulation, and therefore the analysis and documentation may take time.

About a quarter of the companies disclosed information on the determination and allocation of transaction prices. The companies, for example, made the following disclosures on this matter:

³ IAS 11 Construction Contracts and IAS 18 Revenue.

"Some consideration paid to customers is being assessed not to be a payment for a distinct service, and thus is being accounted for as a reduction of a transaction price e.g. reduction of revenue due to the implementation of the standard. The Management estimates this will have a yearly level impact of EUR 4–6 million."

"The transaction price is primarily comprised of individual visits according to the price list or annual, daily or hourly rates based on customer agreements. In most cases, the price concerns an individual performance obligation. In some cases, the price includes a variable element of consideration (e.g. discount, penalty charge), which is allocated to one or more performance obligations."

"In project business the contracts usually have clauses for penalties of late deliveries, or penalties if the delivery cannot take place in time due to the customer. The penalties for late deliveries are currently accounted for as provisions for costs, when their probability is more likely than not to occur. The penalty payments received from customers have been recognized as sales when the penalty clauses in the contract have been satisfied. Such penalties will be treated as a variable consideration in IFRS 15 and will be required to be estimated at contract inception. According to analyses this will reduce the Group's recognized revenue to some extent, as the penalties accounted for as costs are to be deducted from sales according to IFRS 15."

"Revenue recognition may deviate from current practice with respect to contracts in which there is a financing component. In terms of X and Y, the accounting procedure might differ in future from the current practice. In X projects, advances are received from customers. The arrangement might include a significant financing component, in which case the company has to adjust the amount of the promised consideration with the impact of the time value of money (revenue to be recognised and financing expenses)."

Information disclosed by companies on step 5: Recognise the revenue

Revenue is recognised when control is transferred to the customer. Based on current standards, revenue is recognised when either significant risks and benefits have been transferred to the buyer or based on the percentage of

completion. In accordance with the new standard, it is first assessed whether control of the product or service under the performance obligation is transferred over time. If this is not the case, control is deemed to transfer at a point in time. The timing of recognition may change on account of both differences in the principles underlying the regulation and the more specific requirements contained in the new standard.

Almost half of the companies described how performance obligations are satisfied and revenues are recognised, for example as follows:

"The Group has assessed the impacts of IFRS 15 and foresees provisional changes in the revenue recognition method in two business lines.

– In long-term X agreements, the customer value is created over time during the contract period. Currently, the percentage of completion is calculated on the basis of the proportion of the contracted services performed. In accordance with IFRS 15, the revenue will be recognised over time, based on costs incurred. Due to the maintenance schedules this typically delays the revenue recognition in a contract. However, the impact on Group net sales is in large extent mitigated by having a wide portfolio of agreements in different stages of lifetime.

– In X sales projects, the percentage of completion is currently measured based on work performed. In accordance with IFRS 15, the revenue will be recognised over time, based on costs incurred. The change delays the revenue recognition of a project significantly, but also in this context, the wide portfolio of projects in different stages should mitigate the impact on Group net sales.

The two business lines together represent, depending on the year, approximately 10–15% of the group's net sales. The estimated combined restatement impact in equity is approximately EUR -10 million."

"Of the projects, the ones significant as regards IFRS 15, are those for which the Group receives milestone payments from collaboration partners. Milestone payments normally comprise a single upfront payment received on signing the agreement, and milestone payments conditional on the progress of the project. In addition, payments related to commercial rights to

the finished product, such as royalties, may be agreed in the agreements. As X may be conducted through many service providers, the collaboration partner can utilise the research results conveyed on signing in its own business operations. Assessment of the impact of IFRS 15 on the recognition of revenue from these agreements will be completed during the 2017 financial year."

"The new standard has a significant impact on the revenue of the group and on the relative profitability, but the impact on the absolute profitability is estimated being minor. The impact arises mostly from the application guidance in the standard for principal versus agent considerations: this will define the way the revenue is recognised for X, which are retained by the group. The group preliminary interprets that the products and services would be recognised as revenue in the net amount of the consideration which is the amount that equals the difference between the sales price and purchase price (previously recognised in revenue at the gross amount, which equals the sales price of the customer contract.) For the financial year 2016 the change described above would reduce the revenue of the group according to the preliminary estimate EUR 8–10 million, with no impact to the result of the group."

"Based on the preliminary assessment the impact is expected to be mainly limited to revenue recognition of X contracts, where revenue recognition is expected to occur over time, measured based on percentage of completion method, as the customer obtains the control of each asset i.e. separately identifiable performance obligation. For X contracts, a performance obligation typically means the delivery and installation of a single unit or solution. Application of IFRS 15 will have a material impact on the company's consolidated financial statements. Reported sales and operating profit (EBIT) will be impacted due to changes in timing of revenue recognition."

Which revenue streams may be affected by the implementation of the standard?

The implementation of the new standard will affect different companies differently. The companies' notes included the following considerations regarding the revenue streams that will be affected most by the standard, or the kind of signifi-

cant judgments the companies will have to make in connection with the implementation of the standard.

- **Principal versus agent:** Is the company's revenue stated in gross terms or only in terms of the sales commission, or net consideration, received?
- **Licences:** New requirements concerning the treatment of licenses are expected to bring the recognition of revenue forward in some companies and delay it in some others compared to present practice.
- **Performance obligations satisfied over time or at a point in time:** For some companies, the new standard means that they will shift from revenue recognition at a point in time to recognition over time (previously percentage of completion method of revenue recognition). At the same time, some companies will have to give up their previous practice of percentage of completion method when the new requirements enter into force. Certain companies currently applying the percentage of completion method of revenue recognition intend to revise the determination of the percentage of completion so that they shift from the milestone method (based on output), measuring the achieved project phases, to the cost-to-cost method (based on input), measuring the costs incurred.
- **Transaction price:** The determination of stand-alone prices and variable considerations are giving rise to challenges to some companies.
- **Contract with a customer:** The identification of contracts with a customer under framework agreements may be problematic.
- **Management judgment and estimates:** Some companies mentioned that management judgment will be used in the future in several matters related to the recognition of revenue.

The standard will be implemented on 1 January 2018 – retrospective transition is the more popular option

Almost all companies reported they would apply the standard as of 1 January 2018. The standard allows companies to choose between two different transition methods. One option is to adjust the information for the comparative period, in which case the company can use the concessions

permitted under the standard, namely practical expedients. One such expedient is that contracts that began and ended in the same annual reporting period do not need to be restated. Another expedient is related to the determination of variable consideration for contracts that are already completed. The other transitional method option is to recognise the impact through equity at the date of initial application, i.e. 1 January 2018 where the financial year is the calendar year. If the company opts for the latter approach, it will apply the new standard retrospectively only to contracts that are not completed on 1 January 2018. In this case, the company must also provide the additional disclosures required by the standard.

Approximately one third of the companies stated that they intend to fully apply the retrospective transitional method. A slightly smaller group, about a fifth of the companies, stated they would recognize the impact at the transition date in equity. Every tenth company told they had not yet decided their approach to the transition, and the rest had not yet formed an opinion on the topic. The final transitional method will be clarified or may still change in several companies during 2017. If the process of the implementation of the standard is delayed, the retrospective adjustment of the 2017 figures, in line with the new standard, may prove challenging.

Quantitative information was seldom provided

The ESMA Public Statement encouraged companies to also provide quantitative information as early as possible, meaning information on the extent of the financial impact of the new standard on the amount or timing of revenue to be recognised. However, ESMA also pointed out that if such information is provided, it must be made clear to the users of the financial statements that the actual figures may deviate from current estimates. Since the financial statements 2017 will be published after the entry into force of the new standard, ESMA considers that quantitative information should be disclosed at the latest in the financial statements 2017. ESMA is of the opinion, however, that quantitative information should already be disclosed in the interim reports in 2017 if there is reliable quantitative information available.

Only a few companies disclosed quantitative information on the impacts of the implementation of the standard in their financial statements 2016. Perhaps many companies had

not progressed so far in their implementation projects, while preparing their financial statements 2016, that they could have disclosed reliable information. A majority of the companies, however, disclosed other information that allowed the reader to assess the impacts of the implementation on the financial statements. Other European IFRS enforcers have also found that the quantitative information provided was scarce.

Companies will also have to review the definition of materiality from the viewpoint of the new standard. Even if the company were to conclude in its analysis that the new standard does not have a material impact on the company at the time of transition, the company will also subsequently have to assess whether the matter will become material in the future.

Preparation of new notes should be launched well in advance – it may be that the information cannot be readily collected afterwards

The notes required by the standard shall be presented in the annual financial statements for 2018. The five-step model included in the standard is also reflected in the notes, since each step includes disclosure requirements. Also for this reason, it is important to analyse and document every step in connection with the implementation. Below is a presentation of a few examples of what the five-step model may mean with respect to notes to financial statements.

- **Step 1: Identify the contract with a customer**
Contracts with customers shall be disaggregated into categories, for example based on contract type (e.g. contracts with a fixed price, contracts billed based on time or material) or the duration of the contract (e.g. short- and long-term contracts). (IFRS 15.114, IFRS 15.B89) It is the responsibility of the companies to consider the level of detail of the descriptions and figures to present in order that the users of the financial statements would understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. (IFRS 15.110)

- **Step 2: Identify performance obligations.** There shall also be information of performance obligations in the financial statements, including when the company typically satisfies its performance obligations, what are significant payment terms, obligations for returns and refunds as well as the different types of warranties and related obligations. (IFRS 15.119)
- **Step 3: Determine the transaction price.** For example, in estimating a variable consideration, the company shall assess whether the expected value or most likely amount better indicates the consideration to which the company is entitled. (IFRS 15.53) If significant judgments were made in the context of determining the transaction price, the company shall present information in its financial statements on the methodologies, input data and assumptions used in the determination of the transaction price. (IFRS 15.126(a))
- **Step 4: Allocate the transaction price to the performance obligations.** If significant judgments were made in the context of allocating the transaction price, the company shall present information on them in the financial statements, for example on the assessment of stand-alone selling prices and the allocation of discounts and variable consideration. (IFRS 15.126(c)) In addition, the company shall, among other things, present the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied at the end of the reporting period; and an explanation of when the entity expects to recognise that amount as revenue. (IFRS 15.120)
- **Step 5: Recognise the revenue.** If a company is recognising revenues over time, it shall explain the methods used to recognise revenue (e.g. a description of methodologies based on output or input) and explain why the methods used provide a faithful depiction of the transfer of goods or services. Information shall be presented on significant judgments pertaining to the timing of satisfaction of a performance obligation. (IFRS 15.124-125)

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